Testimony of

William V. Humphreys

On Behalf of the

AMERICAN **BANKERS** ASSOCIATION

Before the

Subcommittee on Finance

Of the

Committee on Small Business

United States House of Representatives

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Chairman Schrader, Ranking Member Buchanan, and members of the Subcommittee, my name is William V. Humphreys, President and CEO of Citizens Bank, Corvallis, OR. Citizens Bank is a 52 year old community bank, with over $410 million in assets, serving 10 communities throughout Oregon's Willamette Valley. We are proud to have been designated in a recent US Banker Magazine to be among the strongest 200 community banks in the nation. Our strategic business focus is on funding small businesses and farmers throughout our market area. I am pleased to be here today on behalf of the American Bankers Association (ABA), which brings together banks of all sizes and charters into one association. The ABA works to enhance the competitiveness of the nation's banking industry and to strengthen America's economy and communities. Its members – the majority of which are banks with less than $125 million in assets – represent over 95 percent of the industry's $13.5 trillion in assets and employ over 2 million men and women.

The topic of SBA lending for small businesses is important and timely. The efforts that have been made by this Subcommittee, the Congress as a whole, and the Administration to improve the environment and opportunities for small businesses through changes to the SBA program have been needed for many years and, more importantly, are beginning to have an effect. The SBA program will be an important source of credit to the small business community as our nation struggles to recover from the recession.

Even during this recession, banks continue to be active lenders. Increasing the total volume of loans is indeed a challenge as the demand for loans continues to fall significantly. History shows that during a recession loan demand declines as businesses experience slowdowns, reduced cash flows make it hard to repay debt, and loan underwriters become more cautious about risk. In spite of these challenges, two out of three banks increased their total volume of loans in the first quarter of this year.

Citizens Bank increased total business loans by 8% in 2008, the fastest growing portion of our balance sheet.

Naturally, banks are following prudent underwriting standards to avoid losses, and bank regulators demand that they do so. Against the backdrop of a very weak economy, it is only prudent that all businesses exercise caution in taking on new financial obligations. Bankers are asking more questions of their borrowers, and regulators are asking more questions of the banks they conduct examinations. Let me assure you that banks will continue to be the source of financial strength in their communities by meeting the financial needs of businesses and individuals in both good times and bad. Banks in every state in the country are actively looking for good loan opportunities. Even in a weak economy, many small businesses are strong borrowers. The SBA, in partnership with America's banks, can play an even larger role in helping small businesses meet the challenges of this economic downturn by expanding their guarantee program and by reducing some of the restrictions currently built into the system.

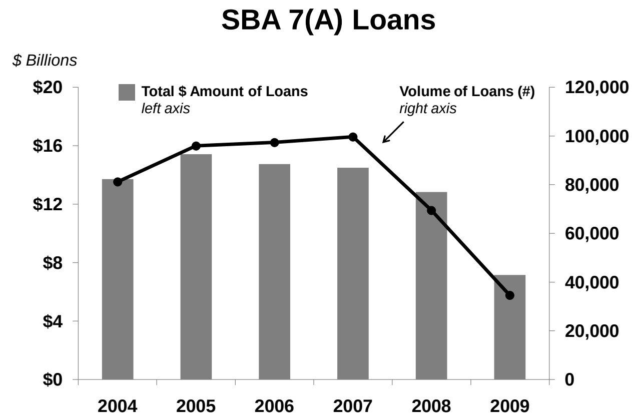
The focus of this Committee is important, because small businesses are drivers of new ideas, new employment, and new economic growth. Banks like mine are only as strong as the quality of our small business borrowers, so it is an imperative that we find ways to offer them the financing they need to ensure success. While some might think the banking industry is composed of only large global banks, the vast majority of banks in our country are community banks – small businesses in their own right. In fact, the Small Business Administration defines a small business as one that has fewer than 500 employees. By this measure, over 8,100 banks – 97 percent of the industry – would be classified as small businesses. Even more telling, ***over 3,500 banks (41 percent) have fewer than 30 employees***. Banks like mine have been an integral part of our communities for decades – sometimes more than a century – and we intend to be there for many more years to come.

I would like to focus on three critical points today:

- Changes that enhance bank participation in SBA programs have made strides in creating opportunities for small businesses, yet more needs to be done.
- Recent legislative proposals contain additional changes to SBA that should stimulate lending.
- Further changes would stimulate more lending to small businesses.

I will address each of these points in turn.

I. Changes that enhance bank participation in SBA programs have made strides in creating opportunities for small businesses, yet more needs to be done.



2009 values equal SBA's 1st and 2nd fiscal quarter values annualized.

Source: Small Business Administration

The SBA program has struggled over the last several years. As can be seen on the chart at the right, SBA fiscal year 2008 loan volume figures showed a 30 percent decline from 2007 in its flagship 7(a) loan guarantee program, and fiscal year 2009 figures put the 7(a) program on pace to have a 50 percent reduction in volume compared to fiscal year 2008. The economy is certainly playing a significant role in overall loan volume decline. However this decline is also due to SBA programs becoming too costly and difficult for lenders and small businesses who wish to access the program. Banks like mine have determined that the cost, inconvenience, and risk associated with obtaining a SBA guarantee often exceeds its value. In order to reverse the current downward trend in the 7(A) program, the SBA needs go beyond an increase in the amount of the guarantee; it needs to offer an improved value proposition. Current restrictions involving cost, collateral, refinancing, and prepayment penalties, among others, should be addressed.

Although many improvements are needed, much has already been done. This Committee has consistently worked to maintain the integrity of the 7(a) program and we applaud your efforts on the Recovery Act to enact the small business provisions. Already, the SBA is making progress to implement these important provisions.

Less than one month after the Act's passage, SBA had made $375 million available – over half of the funding provided in the legislation – to make access much easier for the two most popular lending programs. The act temporarily increases the guarantees to up to 90 percent on SBA's 7(a) loan program, which will be helpful as banks work to extend credit during the recession. It also temporarily eliminates fees for borrowers on 7(a) loans and eliminated fees for both borrowers and lenders on 504 Certified Development Company loans. SBA Administrator Karen Mills noted that average weekly loan volume was up 28 percent in the 7(a) program and 22 percent in the 504 program immediately following passage of the Act, and that participation among banks had likewise increased.

Further, the SBA expanded eligibility to small businesses in the 7(a) program by applying the broader standard used currently in the 504 program. Now, businesses will be able to qualify with a net worth that does not exceed $8.5 million and an average net income under $3 million (after federal income taxes) for the preceding two fiscal years. These very positive changes will mean that an additional 70,000 among the largest of our small businesses will be eligible to participate in the 7(a) program.

Just last month the America's Recovery Capital (ARC) program was initiated, which provides funding of up to $35,000 for six months to help small businesses facing immediate financial difficulty. These loans are interest-free to the borrower, and are 100 percent guaranteed by the SBA. In addition, the loans have no fees associated with them and repayment will not begin until 12 months following the final disbursement. This is an important source of funding for many of our smallest businesses.

Other provisions from the Act include provisions that raised the maximum contract that can qualify for an SBA Surety Bond guarantee from $2 million to $5 million, and additional funding to microloan intermediaries, as well as funding for the technical assistance needed to accompany these loans.

All of these initiatives promise to help small businesses during this recession, and should be continued past their current authorization periods in order to reach even more small businesses.

II. Recent legislative proposals contain additional changes to SBA that should stimulate lending.

Chairwoman Velazquez has introduced a legislative proposal which the ABA believes could move the SBA programs forward even more.

First, the legislation calls for the establishment of a program within the SBA to assist with outreach to small lenders who are not participants in the SBA's 7(a) loan program. This is vitally important. SBA lending is a very specialized area of lending that requires skilled personnel with expertise in the policies and procedures of SBA lending. When a community bank decides to serve the SBA marketplace they are making a commitment that goes beyond simply making the loan, they are making a financial commitment to hire the personnel to supply and market this type of loan product to their customers. Providing a dedicated outreach effort to these lenders – primarily community banks like mine – will only increase lenders' willingness to participate in the agency's program. Currently, there are over 2,000 lenders that are either Certified Lenders Program (CLP) or Preferred Lenders Program (PLP) lenders in the 7(a) program. This number represents just one-quarter of the over 8,000 banks in this country. A program that specializes in outreach to non-participating lenders will be helpful to reach these lenders, which in turn will help small businesses receive capital.

Second, the legislation seeks to make the Rural Lender Outreach Program[1], Community Express[2] and the Patriot Express Program[3] permanent. Clearly, each of these programs shares a common goal: to assist borrowers that have not accessed SBA programs or have traditionally had limited access to capital. The Rural Lender Outreach Program, for example, was established to address the needs of borrowers and lenders in remote rural areas of the country. However, information is not readily available about the program on SBA's Web site. I feel that the SBA has fallen short on a critical part of establishing a new program – promotion and marketing. Because of this, the potential benefit of these programs has not been fulfilled. In order to reach more borrowers through the Rural Lender, Community Express and Patriot Express Programs, it is vital that the agency expand its human and technology resources to promote these programs to both lenders and their target markets.

III. Further changes would stimulate more lending to small businesses.

In spite of the many improvements this Committee has endeavored to make, there are a number of improvements that would provide additional incentives to small businesses and banks that would enable even broader participation.

Extend the Provisions of the Stimulus Package

Congress as part of the economic stabilization package increased the loan guarantee level in the 7(a) program to 90 percent and also decreased the fees for both the borrowers and the lenders. Both actions have provided a much needed boost for lender participation in the program. Both the guarantee and fee relief are scheduled to expire at the end of the next fiscal year. We believe these provisions that expand both the guarantee and fee relief should be extended for an additional two years beyond the 2010 expiration date. While we are all hopeful that the economy will regain its footing over

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[1] The Rural Lender Outreach Program was designed to alleviate the trend of declining lender participation in the 7(a) program, particularly among lenders in rural areas, by reducing application burdens for borrowers and lenders in rural areas through abbreviated application and documentation requirements.

[2] The Community Express Program is a Pilot Loan program which was recently redesigned to enable approved SBA lenders to adopt SBA's most streamlined and expedited loan procedures to provide a unique combination of financial and technical assistance to borrowers located in underserved communities.

[3] The Patriot Express Program is a Pilot Loan Initiative for veterans and members of the military community wanting to establish or expand small businesses.

the next six months, we are also realistic in understanding that the recovery may be very slow. ABA's Economic Advisory Committee (EAC) believes that the recession will officially be over by year-end, but the growth will not be strong enough to generate a large quantity of new jobs. The compounding affect of job losses since the recession began is severely impacting small businesses, and will continue to do so even after the economy returns to growth. The more that we are able to supply additional capital to our country's small businesses, the better chance we have at keeping businesses alive, which in turn will prevent further layoffs. Additional capital through lending will create an environment where small businesses will begin to rehire or add new jobs. Maintaining the 90 percent guarantee, with lower fee levels, through fiscal year 2012 will assist in that effort.

Eliminate or Reduce the Restriction on Refinancing

The SBA allows no refinancing of existing debt by the bank that currently holds the debt. This restriction often prohibits the borrower from obtaining new financing critical to continued success. In many circumstances banks would like to make new and consolidated advances, but if the bank already has a deal on the books, that loan cannot become part of the new deal. This restriction often causes the bank to write new loans without the help of the SBA, or ask the borrower to seek help from another lender.

Improve the Quality of the Guarantee

The SBA guarantee is only valid if certain conditions are strictly adhered to. The collateral assets, and often the business, must be liquidated prior to payment on the guarantee by the SBA. This process can be delayed by bankruptcy, by difficult repossession issues, and other factors. The SBA also sends the claim to their legal department where lawyers seem to seek ways to find the bank in violation of the guarantee agreement.

Improve the SBA Guarantee Approval Process

Generating the information and documentation required by the SBA is not easy. Many small banks have found it necessary to seek the help of third party "packagers" who help with gathering the data necessary to gain approval. This only creates additional time and expense for the borrower. This process could be significantly streamlined.

Enhance the Human Resources Capacity of the SBA

There is a very practical barrier to the success of these programs: having the staff necessary to implement, promote, market, and manage the many initiatives of the SBA. We request that the Committee investigate the human resource needs of the SBA. Over the last eight years, the SBA staff has been reduced by nearly 1,000. This has been done through consolidation, retirements and attrition. Since January 2009, the SBA has taken on nearly eight new loan programs and seen a sizeable increase in their budget allocation to implement and carry out these programs. Yet, the number of staff assigned to carry out the old and new programs has not been increased and, in fact, the program responsibilities of these employees have increased. SBA has thousands of partners and many more that desire to establish or reestablish a relationship with the agency. Without adequate levels of personnel to meet the needs of these partners, the small businesses that they serve will suffer.

Conclusion

The initiatives and new programs launched by the Administration and by Congress have great potential to help thousands of small businesses. These programs should be improved further and given the time to work. In addition, the SBA must be given the human resources to implement these initiatives, many of which are new to the SBA. ABA is prepared to work with this Subcommittee on finding ways to improve the SBA program, with the goal of enhancing credit availability to small businesses throughout our nation.